

## THE ST. LOUIS REPUBLIC

PUBLISHED BY GEORGE KNAPP & CO.,  
Charles W. Knapp, President and Gen. Mgr.  
George L. Allen, Vice President.  
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## TAXATION OF MORTGAGES.

The article herein, timely, because of the proposed constitutional amendment, taxing mortgages, is a chapter from "A Treatise on the Law and Practice of Taxation in Missouri," by Frederick N. Johnson of the St. Louis bar. Published by E. W. Stephens. By kind permission of author and publisher, from advance sheets. The work is now in press.

UNDER the law of Missouri, mortgages of real estate, and notes secured by deeds of trust upon real estate, are personal property, and are required to be listed by the holder for taxation at his domicile, like other personal property. The statute provides that the term "credits" shall be held to include "all money loaned or invested and all indebtedness secured by deed, contract, mortgage or pledge of property of whatsoever kind." It is therefore immaterial where the property upon which the mortgage or deed of trust is a lien, whether in this State or elsewhere. As already shown, the statute also makes taxable at the domicile of the owner in this State all notes, bonds or other securities held in any other State or Territory. The State has therefore exercised its utmost power in the taxation of this class of property. It taxes all the land in the State to its full value without deduction for mortgage, and also taxes all the mortgages on the property in other jurisdictions belonging to the citizens of this State, whether the bonds and notes or other evidences of debt are in this State or not. The effect of this system, as already shown, is to tax both the property and the credit whose value rests upon the property.

## Failure of the Tax on Mortgages.

The section fails, not from any lack of exercise of the lawful power of the State, but because it is practically impossible to compel the listing of the mortgage notes for taxation, and with the exception of the comparatively small amount secured from administrators and trustees, and indirectly through the taxation of banks and trust companies, mortgages have practically gone untaxed. The sense of injustice, therefore, that the owner of the property feels in being required to pay a tax or the full assessed value, when its value to him is reduced by the amount of the mortgage, is increased by the recognized fact that the mortgage as a rule escapes taxation.

Two methods have been applied to this admitted failure of the law. First, the exemption of mortgages and reaching that class of property through other forms of taxation. This is the system adopted in Massachusetts and other States, where mortgages are virtually exempt from taxation, with a resulting tendency to lower rates of interest on mortgage loans by the attraction of foreign capital. Second, the other remedy suggested is what is known as the California system of taxing separately the mortgage interest and the equity in the mortgaged property, both interests being treated as interests in the real estate for the purposes of taxation. This system was adopted in California in 1873 and is still the law of that State.

This method of taxing mortgage interests in lands was adopted in Oregon by statute, and it was held by the Supreme Court of the United States, in the Federal States, as applied to mortgages owned by citizens of other States and in their possession outside of the State, not to contravene the Constitution of the United States, the court saying:

"The State may tax real estate mortgages, as it may all other property within its jurisdiction, at its full value. It may do this, either taxing the whole to the mortgagor, or taxing to the mortgagee the interest therein represented by the mortgage, and to the mortgagor the remainder. The interest in the mortgage, and the mortgage for the purposes of taxation, either treat the mortgage debt as personal property, to be taxed like other choses in action to the creditor at his domicile, or treat the mortgage's interest in the land as real estate, to be taxed to him like other real property at his situs."

## The Constitutional Amendment Submitted in 1900.

The General Assembly of Missouri in 1899 submitted the California system as a constitutional amendment, to be voted upon by the people of Missouri at the general election in November, 1900. That the substantial identity of our proposed constitutional amendment with the California provision of California may be clearly seen, they are herewith submitted in parallel columns:

PROPOSED AMENDMENT TO MISSOURI CONSTITUTION.

ART. XII, Sec. 22. A mortgage, deed of trust, contract or other obligation by which a debt is secured, shall, for purposes of assessment and taxation, be deemed and treated as an interest in the property affected thereby; except as to railroad and other public utility corporations, in the case of which provision has already been made by law; in case of debt so secured, the value of the property affected by such mortgage, deed of trust, contract or obligation, less the value of such security, shall be assessed and taxed to the owner of the property, and the value of such security shall be assessed and taxed to the owner thereof, in the county, city or district in which the property affected thereby is situated. The taxes so levied shall be a lien upon the property and security, and may be paid by either party to such security; if paid by the owner of such security the tax so levied upon the property affected thereby shall become a part of the debt so secured; if the owner of the property shall pay the tax so levied on such security, it shall constitute a payment thereon, and to the extent of such payment, a full discharge thereof. Provided, that if any such security or indebtedness shall be paid by any such debtor or debtors, after assessment and before the tax levied, the amount of such levy may like any debt be retained by such debtor or debtors, and shall be computed according to the law for the preceding year.

Sec. 23. Every contract hereinafter made, by which a debtor is obligated to pay any tax or assessment of money, land, or any mortgage, deed of trust, or other lien, shall, as to any interest specified therein, and as to such tax or assessment, be null and void.

It will be seen that the Missouri amendment, in the proviso to section 22, incorporates as an addition to the California section the provision that the interest of the owner of the security, as well as that of the owner of the property, "shall be assessed on terms equally fair and just, and in the following words at the close thereof, "this interest hereof being to place these interests in any way in such land or property upon the same plane of absolute equality as to taxation."

The language of this provision was doubtless adopted in recognition of the well-known practice of assessing property at a fraction of its true value. Assuming, then, that property under the present system is assessed on the basis of 25 per cent. of its actual value, the mortgage under the proposed system would be assessed at \$150 to the mortgagee and the equity at \$150 to the mortgagor. This provision for equality of taxation is based upon a principle of fairness, and does away with the anomaly of double taxation under the present system, whereunder the ignorant and helpless are compelled to pay a tax from which others are practically exempt.

Equality of Taxation Between Mortgagor and Mortgagee.

Shifting of the Tax on the Mortgage to the Mortgagor.

The proposed Missouri amendment adopts word for word the language of the California law in providing against the shifting of the tax on the mortgage interest in the land from the mortgagee to the mortgagor. It is obvious that if the tax can be so shifted the only effect of the proposed amendment would be to prevent the double taxation of the present system—that is, the taxation of the land without deduction to the mortgagor, and the mortgage at the same time as personal property to the mortgagee. The mortgagor under this shifting of the tax would continue to pay the tax on the full assessed value of the land as before, as he would pay the tax both on his own equity in the land, and on the interest of the mortgagee. The shifting of the tax, therefore, would be to exempt the mortgagee, or, more accurately, to legalize the existing practical exemption.

Failure of the System in California.

As we are now asked to adopt a system which has been in force in California for over twenty years, it is important to study the experience of California with reference to this very matter. This subject has been carefully investigated by Professor Carl C. Plehm, professor of history and political science in the University of California, in a recent article.

As a result of an exhaustive investigation he finds that the provision against the shifting of the tax from the mortgagee to the mortgagor has been wholly ineffective. He has been the devices to shift the burden of the tax upon the mortgagor that they have come into practically universal use, and printed blanks are used embodying agreements, which have been sustained by the Supreme Court of the State. Professor Plehm says: "Possibly the oldest and certainly the most widely used of these devices is the so-called 'split mortgage,' consisting of a contract separate and distinct from the mortgage, in which the creditor agrees to reduce the interest in case the debtor pays the taxes. The method is so common in the South that all stationers carry regular blank forms of these contracts."

And adds:

"The feeling that the provision of the Constitution which requires the mortgagee to pay the taxes accomplishes no good and really increases the burden of debt, and that its evasion affords a desirable relief, has been the constant and probable motive for this far-reaching expedient rendered in the recent case of the London and San Francisco Bank v. Baxman, 129 Cal. 221 decided March 21, 1900. In this case, it was held that a valid agreement, not simultaneous with or directly a part of the mortgage, providing for the payment of taxes by the mortgagee in case the mortgagor failed to do so, was not void. The court made the constitutional provision entirely devoid of meaning and brings the California system of taxing mortgages into practical conformity with that of Massachusetts. That is, the two parties to the mortgage can make any agreement they please as to the payment of the tax."

"This is it that this famous 'experiment in taxation' has come to mean."

As we are now asked to adopt a constitutional provision of another State, which has been construed by the Supreme Court of that State, will we not adopt this construction?

It is also clearly demonstrated by Professor Plehm, and his testimony in this regard seems to be confirmed by all authorities, that in so far as this shifting of the tax was not effective, the rate of interest upon mortgage loans was increased, and foreign capital diverted from the State. Indeed, this fact seems to be so universally conceded in California that it is recognized by the Supreme Court of California in its opinions above cited.

Michigan has had a somewhat similar experience in attempting to tax mortgages. It was enacted that the mortgagor might pay the tax upon the full value of the land, but that the mortgagee should receive in lieu of interest tax receipts representing that portion of the total tax that the mortgagee represented of the total value. "This law had the effect, first, in causing